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No. 345

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1963

MANUFACTURERS HANOVER TRUST COMPANY, as Trustee under Indenture dated November 5, 1927, made by Henry H. Rogers, deceased,
Petitioner,

v.

UNITED STATES OF AMERICA
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

REPLY BRIEF FOR PETITIONER

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Petitioner respectfully calls attention to the following shortcomings in the Government's argument:

1. By its utter silence on the point, the Government's brief acknowledges that the litigation expenses incurred by the trustee were essential to trust management. As noted in the Petition, pp. 4-6, failure to seek court instructions in this case would have exposed the trustee to absolute personal liability, a risk no court has ever required a trustee to take. The Government's brief, like the decision below, mentions only title aspects of the case, not once recognizing the trust management considerations that dictated the litigation producing the expenses. Where, as here, the litigation involved both property management and title, a standard is needed to determine which Section of the Code should govern—Section 212(2) permitting deduc-

tion of the expenses incurred; or Section 263 requiring their capitalization. The need for such a standard is the true issue before this court; the Government's brief ignores it.

2. The Government's brief asserts that there exists "no conflict of decisions or other cause for review" but cites two cases which have the same essential facts, and which reach opposite results on the deductibility of litigation expenses of a fiduciary where title is involved. Government's brief pp. 6, 7. *Loyd* v. *United States*, 153 F. Supp. 416 (Ct. Cl. 1957) holds that the litigation expenses are deductible; *Parkway Realty Corp.* v. *Commissioner*, P-H Tax Ct. Rep. & Mem. Dec. ¶ 59,050; CCH 18 Tax Ct. Mem. 235 (Tax Ct. Mar. 16, 1959) holds that they must be capitalized. These cases should be added to the conflicting decisions cited by Petitioner. There are thus four decisions, two in the Court of Claims, and two in the Tax Court, all involving essentially the same facts, but reaching the opposite results without laying down any discernible standard which trustees and tax officials in the future can follow or apply. Compare *Loyd* v. *United States*, 153 F. Supp. 416 (Ct. Cl. 1957) and *Trust of Spero* v. *Commissioner*, 30 T. C. 845 (1958) with *Manufacturers Hanover Trust Co.* v. *U. S.*, 312 F. 2d 785 (Ct. Cl. 1963) (the case at bar) and *Parkway Realty Corp.* v. *Commissioner*, P-H Tax Ct. Rep. & Mem. Dec. ¶ 59,050; CCH 18 Tax Ct. Mem. 235 (Tax Ct. Mar. 16, 1959). *Loyd* and *Spero* follow this Court's decision in *Trust of Bingham* v. *Commissioner*, 325 U. S. 365 (1945); the court below, and *Parkway Realty* do not.

3. Authorities cited by the Government are not in point. *Lewis* v. *Commissioner*, 253 F. 2d 821 (2d Cir. 1958) involved deductibility of litigation expenses by the settlor of a trust, who attempted to revoke it, revesting title in him, and did not involve deductibility of litigation expenses by the trustee managing the property. *Bowers* v. *Lumpkin*, 140 F. 2d 927 (4th Cir. 1944) and *Brown* v. *Commissioner*, 215 F. 2d 697 (5th Cir. 1954) both involved deductibility on their individual returns of the legal expenses of beneficiaries claiming trust or estate property. Non-deductibility of ex-

penses of beneficiaries is fully covered in the last sentence of Treas. Regs. § 1.212-1(k).[1] There is a clear distinction under Section 212(2) between the legal expenses of a beneficiary and the legal expenses of a disinterested fiduciary. Beneficiaries incur litigation expenses so that they can enjoy property; trustees incur such expenses in order to conserve and manage it. It is just such ordinary and necessary expenses of property management that Congress intended should be deductible under Section 212(2). Deductibility of trustee's litigation expenses is confirmed by Treas. Regs. § 1.212-1(i).[2]

4. The Government is mistaken when it asserts that the holding below does not conflict with this Court's decision in *Trust of Bingham* v. *Commissioner*, 325 U. S. 365 (1945). The *Bingham* case involved two issues. The more important in amount was the deductibility of some $16,000 of litigation expenses. This Court held these expenses deductible in *Bingham* because they were directly connected with and proximately resulted from trust management. But the Court of Claims below, and the United States here, ignore this holding of the *Bingham* case and refer only to the second issue before the Court, namely the deductibility of a $9,000 payment for legal advice in connection with the distribution of trust assets. So that there can be no further mistake we quote the exact language of this Court in *Bingham*:

> ". . . Section 23(a)(2) [now Section 212(2)] does not restrict deductions to those litigation expenses which alone produce income. On the contrary, by its

[1] "Expenses paid or incurred in protecting or asserting one's right to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible." See Government's Brief at p. 16.

[2] "Reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under Section 212 notwithstanding that the estate or trust is not engaged in a trade or business." See Government's Brief at p. 16, and Petition at p. 14

terms and in analogy with the rule under [illegible] 23(a)(1), the business expense section, the trust, a taxable entity like a business, may deduct litigation expenses when they are directly connected with or proximately result from the enterprise—the management of property held for production of income. . . ." 325 U. S. at 376.

5. Contrary to Petitioner's hopes, the Second Circuit's review of the *Tucker* case has in no respect clarified the allocation issue. *Marcia B. Tucker*, 38 T. C. 955 (1962), aff'd P-H 1963 Fed. Tax Serv. ¶63-5094; CCH Stand. Fed. Tax Rep. (U. S. Tax Cases) ¶9654 (2d Cir. Aug. 7, 1963). There are now two decisions upholding the Commissioner's disallowing (under the guise of "allocating") a portion of the management deductions of trustees by assigning them to tax-exempt income. *Tucker* proceeds on the theory that Section 652(b) of the Code and Section 1.652(b)-3(b) of the Regulations require the disallowance; the decision below holds that the example in Section 1.652(c)-4 of the Regulations constitutes a regulation requiring the disallowance. See Petition at p. 35. Each decision cites the other only for its result, not for its reasoning. To trustees who have become familiar over the years with the system of taxation of trusts and estates established by Subchapter J, it is apparent that the *Tucker* decisions applied Section 652(b) of the Code, and Regs. Section 1.652(b)-3(b) promulgated thereunder, to a situation utterly foreign to their intended and actual scope.[3] The decisions in the *Tucker* and this case give trustees no clue how to allocate when deductions exceed income taxable to beneficiaries or when a trust is other than a "simple trust"; in fact, the Court below expressly disavows passing on the allocation issue in such cases.[4] The uniformity in the system of taxation of estates

[3] A detailed analysis of this point appears in the certified record filed herein at pp. 4-8 of the document entitled "Plaintiff's Supplemental Memorandum." *Id.* the court below the attorney general agreed with petitioner that Section 652(b) has no application to the allocation issue.

[4] See Opinion of the Court Below, in the Petition, p. 29, note 9, and p. 33, note 13.

and trusts desired by Congress in enacting the 1954 Code has been destroyed in this area, and unwarranted distinctions superimposed on an already dangerously complicated subdivision of the tax law.[*] If Section 265 and Treas. Reg. Section 1.265-1(c) are once again given their stated scope, the need for proliferating distinctions disappears, an indication that the analyses of *Tucker* and the court below cannot be right. The reasons set forth in the Petition why this Court should pass on this phase of the case remain valid.

Conclusion

For the reasons stated herein, and in the Petition, a writ of certiorari should be granted.

Respectfully submitted,

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[*] See Lapiner, "We must simplify the Taxation of Estates and Trusts," 49 Am. Bar Ass'n Journal 146 (Feb. 1963)